BACKGROUND

LEGAL CONTEXT OF THE OIL AND GAS LEASING PROGRAM

Lands managed by the Department of Natural Resources were acquired (1) from the federal government through the Congressional Enabling Act of 1889, (2) from the counties, and (3) by gift, purchase and escheat. These lands involve 2,893,040 acres of uplands and 2,000,000 acres of aquatic lands. In addition the department owns approximately 475,000 acres of mineral rights only -- mineral rights which were retained by the state when the land was sold or mineral rights which were acquired through exchange.

Uplands are managed to generate income for support of the various trusts while preserving trust assets for future beneficiaries. Aquatic lands, however, are managed to provide a balance of public benefits for all citizens of the state.

ENABLING ACT

The Congressional Enabling Act of 1889, which admitted Washington to the Union, put limits on the sale, lease and management of state-owned lands. However, these lands may be leased for oil and gas purposes pursuant to statutes set forth by the legislature.

FEDERAL LAND GRANT TRUSTS

Federal land grant trusts are endowments of land by the United States to the state of Washington to be sold, leased or managed to support designated beneficiaries in perpetuity. The federal grant lands were donated to Washington in 1889 in the Congressional Enabling Act providing for admission of the territory of Washington as the 42nd state. These donated lands were expressly reserved in the Act for (a) support of the common schools (§ 10);

(b) erecting public buildings for legislative, executive and judicial use (§ 12-15); (c) the use and support of an agricultural college (Washington State University) (§ 16); (d) a state university (University of Washington) (§ 14); (e) establishing and maintaining a scientific school (Washington State University) (§ 17); (f) state normal schools (now regional universities) (§ 17); and (g) state charitable, educational, penal and reformatory institutions (§ 17). The Washington Legislature has designated the Department of Natural Resources as manager and trustee of the lands to benefit the institutions supported.

Case Law Pertaining to Federal Land Grant Trusts

Seven federal and state cases show how the courts have applied many of the foregoing principles to the sale, lease and management of federal grant trust lands.

In Ervien v. United States 251 U.S. 41 (1919), the U.S. Attorney General sued for an injunction to prevent the New Mexico Land Commissioner, the trustee of New Mexico grant lands, from spending trust earnings for unauthorized purpose to publicize the resources and advantages of New Mexico. The New Mexico Land Commissioner argued that this advertising was a proper administrative expense as it could increase the value of the trust lands.

The U.S. Supreme Court, however, granted an injunction prohibiting these expenditures. It ruled that the trusts were individually created to support public institutions specified in the Enabling Act. Therefore, the trustee could not use proceeds from a specific

trust to benefit the state generally, even if the trust also might be indirectly benefited; rather, Congress intended that the trustee apply the trust earnings to the fund created to "support" the public institution designated in the Enabling Act.

In Lassen v. Arizona, 385 U.S. 458 (1966), the Arizona Highway Department sued the Land Commissioner, the trustee of grant lands, to condemn a highway right of way. The department argued that it need not compensate the trust, since a highway across trust lands would enhance the value of remaining trust lands in an amount at least equal to the value of the trust lands taken. The U.S. Supreme Court rejected the argument and agreed with the Commissioner that the department must pay the trust for the property taken. The Supreme Court stated:

The Enabling Act unequivocally demands both that the trust receive the full value of any lands transferred from it and that any funds received be employed only for the purposes for which the land was given. First, it requires that before trust lands or their products are offered for sale they must be "appraised at their true value" and that "no sale or other disposal . . . shall be made for a consideration less than the value so ascertained . . Second, it imposes a series of careful restrictions upon the use of trust funds. As this Court has noted, the Act contains a "specific enumeration of the purposes for which the lands were granted and the enumeration is necessarily exclusive of any other purpose." [Ervien v. United States, supra.] The Act thus specifically forbids the use of "money or thing of value directly or indirectly derived" from trust lands for any

purposes other than those for which that parcel of land was granted. It requires the creation of separate trust accounts for each of the designated beneficiaries, prohibits the transfer of funds among the accounts, and directs with great precision their administration. "Words more clearly designed . . . to create definite and specific trusts and to make them in all respects separate and independent of each other could hardly have been chosen." [United States v. Ervien, 246 F. 277, 279. All these restrictions in combination indicate Congress' concern both that the grants provide the most substantial support possible to the beneficiaries and that only those beneficiaries profit from the trust.

U.S. v. 111.2 Acres of Land in Ferry County, Washington, 293 F. Supp. 1042, affirmed 435 F. 2d 561 (1970), is a Washington case adopting the principles set forth in Ervien and Lassen. The United States Government sought to acquire state school trust lands for a federal irrigation project. The U.S. argued that, as trust grantor, it was permitted to take the land without paying for it. The court disagreed, stating:

The school lands provisions of the Enabling Act further a liberal policy of school support . . . In this context the principle of indemnity requires that no land or proceeds be diverted from the school trust unless the trust receives full compensation. This principle is explicitly a part of the Washington Enabling Act.

The court concluded that donating school trust lands to the United States would constitute a breach of trust by

the trustee (State of Washington). The court ordered the United States to pay the trust the full market value of the land.

In State v. University of Alaska, 624 P. 2d 807 (February 27, 1981), the State of Alaska sought to include university grant land within Chugach State Park. The university opposed this action and sought a declaratory judgment as to whether the land could be used other than to support the university. The Supreme Court ruled with the university, stating:

Because the land was to be held in trust for the university, we must determine whether inclusion of the land in Chugach State Park caused a breach of the trust. The trial court concluded that the inclusion of university land in the park violated the trust provision of the federal grant. We agree. The use that can be made of park lands as compared to state lands in general is severely restricted. Trees may not be cut, minerals may not be removed, nor can the land be used for raising farm animals. The general principle is that park lands are to be managed in a way that will increase the "value of a recreational experience." It is apparent that this objective is incompatible with the objective of using university land for the "exclusive use and benefit" of the university. The implied intent of the grant was to maximize the economic return from the land for the benefit of the university. This intent cannot be accomplished if the use of the land is restricted to any significant degree.

Oklahoma Education Association Inc. v. Nigh, 642 P. 2d 230 (Okla. 1982), and in Anderson v. Board of Educational

Lands and Funds, 256 N.W. 2d 318 (Neb. 1977), the court recognized the trustee must take necessary precautions to protect the trust assets.

More recently. The County of Skamania et al. vs. The State of Washington (102 Wn. 2d 127 P. 2d (1984^{*}) reaffirmed the responsibility of the trustee as mandated in the Enabling Act. The Forest Products Industry Recovery Act of 1982 (RCW 79.01.1331 - .1339), which permitted purchasers of timber from state trust lands to default on their contracts, or to modify or extend their contracts without penalty, was found to violate Article 16 Section 1 of the Washington State Constitution. The court held that the legislation breached the state's fiduciary duty as a trustee to act with undivided loyalty to the trust beneficiaries and to manage trust assets prudently.

Conclusions from the Legal Background

The Enabling Act and Washington Constitution create an express trust. United States is the grantor; Washington State is the trustee; certain schools, and other designated entities are the beneficiaries of the trust. The congressional intent and purpose in creating these trusts has been construed by the United States Supreme Court to be as follows: The trustee is to sell or manage the granted lands to generate income for the support of those public institutions designated in the Enabling Act. Additional management direction comes from the Washington Legislature, which has the authority to pass laws governing trust management. Such laws are presumed to be valid.

In addition to the constitutional and statutory mandates, the department, as trust manager, possesses certain responsibilities under traditional trust doctrines. The extent to which the whole of common law trust duties apply to a trustee of a federal land grant trust is a judicial question which has not been clearly decided by the courts.

Five common law duties are set forth in this discussion. Two that have been judicially recognized are: (1) The duty to administer the trust in the interest of the beneficiaries and not for the benefit of others, and (2) the duty to use reasonable care and skill to preserve the trust property. Although not directly stated, implicit in the various case holdings is (3) a duty to use reasonable care and skill to make trust property productive of income without unduly favoring present beneficiaries over future beneficiaries. The department, as trust manager and as a creature of statute recognizes that it (4) has a duty as a trustee to follow the Constitution, Enabling Act and laws which affect the state land management programs. Those laws include the Multiple Use Act, Oil and Gas Conservation Act, and other environmental statutes. "Other statutes" include those listed under the heading "State and Federal Laws". This list is not meant to be exclusive. (5) The duty to diversify the management of federal land grant trust assets so as to reduce risk of loss has not been specifically addressed by courts. Diversity of management practices to moderate economic risks is seen by the department as its responsibility and is a program goal.

The whole of these principles lead to the following: In managing the federal land grant trusts the department is to be primarily concerned with generating income for trust beneficiaries but must manage by following prudent practices

and by taking precautions to preserve the trust assets for future beneficiaries. The specific steps taken must be in conformance with the Enabling Act, Washington Constitution and legislation which affects management of the trust assets.

FOREST BOARD TRUSTS

Forest Board trusts are forest lands acquired by the state by gift, purchase or transfer by the county to perpetuate the forest resource in Washington. The two types of Forest Board lands are Forest Board Transfer and Forest Board Purchased. Both types are to be managed as state forest lands to benefit the county. The legislature has directed that these lands be held in trust and administered and protected as other state forest lands (Chapter 76.12 RCW). Forest Board lands are available for oil and gas lease by the state provided the mineral rights were acquired at the time of gift, purchase or transfer by the county.

AQUATIC LANDS

Currently, the state asserts ownership to approximately 11 square miles of harbor area, 140 square miles of shorelands and 205 square miles of tidelands. The state's ownership also includes the beds of all marine waters within 3 miles of shore and all bedlands of the Puget Sound.

The Department of Natural Resources, as the proprietary agent for the state's aquatic lands, is authorized to issue leases, rights of way and easements on aquatic lands. It may also sell valuable materials from these lands. In addition, the Multiple Use Act (RCW 79.68.080) passed in 1971, requires the department to "foster the commercial and recreational use of the

aquatic environment for the production of food, fibre, income, and public enjoyment from state-owned aquatic lands".

A comprehensive law affecting the state's aquatic lands was passed in 1984. It identifies water-dependent uses as priority uses for state aquatic lands. The law directs the department to manage aquatic lands to provide a balance of public benefits, including public access, environmental protection, renewable resource use and revenue generation consistent with the purpose of the law. (Chapter 79.90 RCW.)

STATE AND FEDERAL LAWS.

The Federal Clean Air Act, 42 U.S.C. 7401, et seq., establishes provisions relating to air quality standards, emission controls, methods of achieving or preventing deterioration, and protection of visibility. In managing state lands, the department will ensure that necessary permits are obtained by the operator and applicable regulations are followed.

The Federal Endangered Species Act, 16 U.S.C. § 1531, et seq., with some stated exceptions, prohibits specific acts relating to endangered and threatened species designated under the Act. The department abides by this Act in its oil and gas leasing and other land use decisions.

The State Environmental Policy Act (Chapter 43.21C RCW) directs that to the fullest extent possible, policies, regulations and laws of Washington are to be interpreted and administered in accordance with the policies set forth in the Act, and that all branches of government, including state agencies, follow the guidelines and procedures specified in Chapter 43.21C RCW in planning and decision making. The department, as a state agency, must comply with the requirements of SEPA.

The Oil and Gas Conservation Act (Chapter 78.52 RCW) creates a comprehensive state-wide system of laws and regulations governing oil and gas practices on private and public lands. The purpose of the Act is to foster, encourage and promote the development and use of oil and gas resources in the state, to prevent waste, to assure maximum economic recovery of oil and gas and to conduct operations that will maintain a safe and healthful environment for the people of the state. The regulations establish minimum standards for oil and gas drilling and production practices. As a public land manager the department must comply with the Oil and Gas Conservation Act and require its lessees to comply with this Act.

The Water Code - 1917 (Chapter 90.03 RCW) administered by DOE, establishes guidelines for diversion, maintenance of minimum flows and levels, and protection of standing or flowing surface waters of the state. Regulation of Public Ground Waters (Chapter 90.44 RCW), supplements Chapter 90.03 RCW. It extends the applicable statutes for surface waters to the ground waters of the state.

The Water Pollution Control Act (Chapter 90.48 RCW), administered by the Department of Ecology (DOE), has promulgated regulations for the maintenance and protection of state water resources. Minimum standards are provided. Compliance with the minimum standards is mandatory.

The Hazardous Waste Disposal Act (Chapter 70.105 RCW) administered by DOE, promulgates regulations for designation, management and disposal of hazardous materials and waters.

The Shorelines Management Act of 1971 (Chapter 90.58 RCW), administered by DOE, established a state policy to provide for the management of state shorelines by planning and fostering all reasonable and appropriate uses. Local

government administers the permit system provided by the Shorelines Management Act and local master programs approved by DOE. The department will require its oil and gas lessees to obtain appropriate permits required under the Shorelines Management Act.

The Hydraulics Code (RCW 75.20.100) is part of the Fisheries Code. Pursuant to the Hydraulics Code, a person or government agency proposing any act that will use, direct, obstruct or change the natural flow or bed of any river or stream or that will use any of the waters of the state or material from the streambed, may not commence such activity without approval from the

Department of Fisheries or Game as appropriate. When the department leases state lands for activities which fall within the purview of the Hydraulics Code, the lessee or permittee shall obtain a permit.

The Multiple Use Act (Ch. 79.68 RCW) directs the department to use a multiple use concept in the management and administration of department-managed lands when it is in the best interests of the state and the general welfare of the citizens, and is consistent with trust provisions where applicable. Multiple use is defined as providing for several uses simultaneously.

OVERALL MANAGEMENT DIRECTION

The department believes that coordinated planning between management programs can provide income to the state and the trusts from a variety of activities yet maintain a healthy natural environment for present and future generations.

In 1984, the department adopted a management plan for department-managed

Forest Land Management Goals

Conserve and enhance the natural resources of state forest land.

Provide a sustained yield of timber through intensive forest management.

Integrate the needs of nontimber resources into the management of the timber resource.

Protect from major losses, such as those caused by fires, insects, animals and diseases.

Provide financial support that balances the level and flow of revenue to the trusts.

Provide for both the short-term and long-term needs of the trusts.

Diversify management practices to moderate economic risks.

Anticipate and respond to market opportunities.

Provide social and economic benefits.

Provide for multiple use on forest land.

Contribute to the viability of the forest products industry.

Contribute to state energy production.

forest lands and issued a proposed policy plan for aquatic lands. Since the Oil and Gas Leasing Program affects both forest and aquatic lands, the goals of their management plans are repeated here. The Oil and Gas Leasing Program goals further define forest and aquatic land management.

Aquatic Land Management Goals

Conserve and enhance aquatic lands and associated resources.

Meet or exceed environmental quality standards.

Maintain or improve the productivity and usefulness of aquatic lands.

Provide high quality habitat for wildlife on state aquatic lands.

Provide social and economic benefits.

Promote access to and recreational use of state aquatic lands.

Encourage water dependent uses.

Promote the production on a continuing basis of renewable resources.

Allow suitable state aquatic lands to be used for energy and mineral production.

Generate income from use of aquatic lands.

Oil and Gas Leasing Program Goals

Conserve and enhance the natural resources of state lands.

Integrate oil and gas resource management with the management of other state land resources.

Protect from and reduce or eliminate losses caused by erosion, pollution of ground and surface waters and disruption of wildlife habitats.

Provide financial support.

Provide a financial yield from oil and gas activities through lawful land management.

Provide for both the short-term and long-term needs of the trusts and the public.

Anticipate and respond to varying levels of oil and gas industry activities.

Integrate land uses to moderate economic risks.

Provide social and economic benefits.

Provide for multiple use on state lands.

Contribute to the potential of the oil and gas industry.

Contribute to state energy production potential.

THE DEPARTMENT OF NATURAL RESOURCES

The legislature's first session in 1889 established the State Land Commission to supervise and control public upland and aquatic lands. Another act during that session created the state School Land Commission to supervise sale and leasing of school lands. In 1893, the two commissions were combined into the State Board of Land Commissioners. This board was replaced in 1897 by the Board of State Land Commissioners.

The State Board of Forest Commissioners was formed in 1905 to supervise protection of forest lands in the state. In 1909, the Board of State Land Commissioners membership was reorganized and administrative control over the Capitol Building Grant lands was placed under the State Capitol Commission. Powers of the State Board of Forest Commissioners were expanded in 1911 to include forest policy and management as well as protection.

The complete revision of land administration came in 1921 with the passage of the Administrative Code. Duties of the Board of Commissioners and the State Forester were vested in the new Department of Conservation and Development and its Division of Forestry. In addition, the Commissioner of Public Lands assumed most of the duties of the Board of State Land Commissioners. The State Capitol Commission was replaced by the State Capitol Committee.

The State Timber Resources Board, established in 1945, was the first major attempt to consolidate state grant and trust land management into one agency. The matter became controversial and was rejected by a referendum of the people in 1946. Except for aquatic lands the only state land not under control of the new board was University Grant land,

which was left to the University of Washington Board of Regents.

In 1951 a committee on state government organization was formed. In its first report it recommended a sweeping reorganization of public land management. A bill introduced in 1953 failed to gain support, but the committee's second report restated its conviction that a single forest and land management agency be created. This attempt was successful and in 1957 the legislature established the Department of Natural Resources to administer state grant, trust and aquatic lands (RCW 43.30.030).

A five-member Board of Natural Resources was formed to establish policies governing the department and to make necessary regulations to carry out their duties. The Board is comprised of the Governor; the Commissioner of Public Lands; the Superintendent of Public Instruction; the Dean of the College of Agriculture, Washington State University; and the Dean of the College of Forest Resources, University of Washington.

However, the department, not the Board, holds the principal decision making role on oil and gas leasing. The department promulgates rules and regulations and establishes lease terms and conditions (RCW 79.14.020 through .900 and Chapter 332-12 WAC). The Lands Division supervises proprietary activities and acts as lead agency for the oil and gas program fulfilling requirements of SEPA for uplands. The Marine Land Management Division fulfills the same role for aquatic lands. The Division of Geology and Earth Resources acts as the agent for the Oil and Gas Commission and as such carries out the requirements of

the Oil and Gas Conservation Act and the orders of the Committee.

The diagram and map on pages 13 and 14 outline the operating structure of the

department. The divisions carry out the research and develop the programs. The Areas then put the programs into operation in the field.

Table 1 Department of Natural Resources Table of Organization

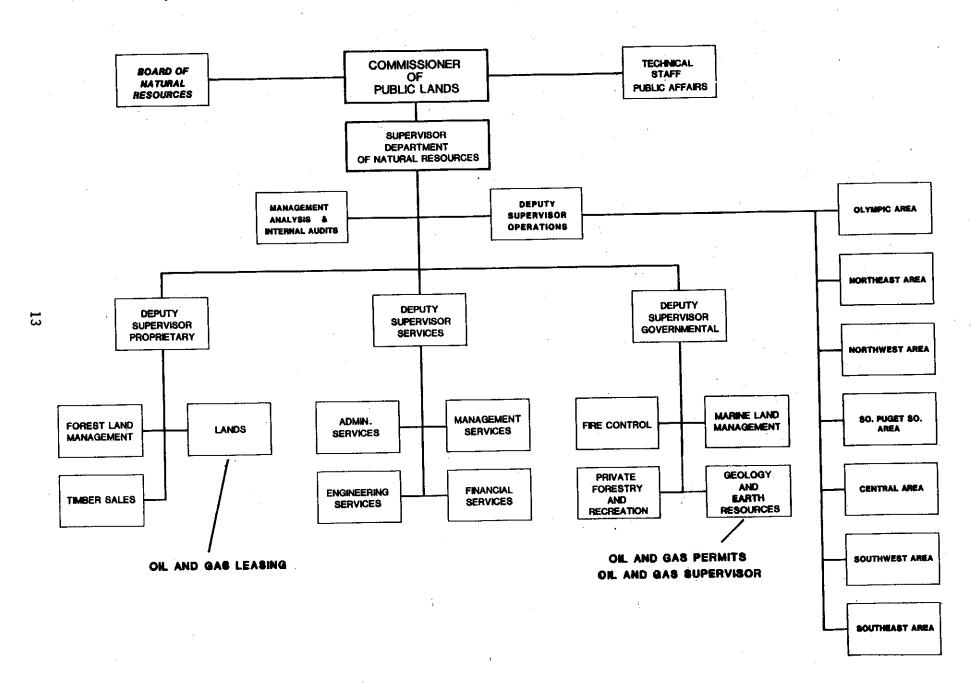


Figure 1 Department Area Management Boundaries STATE OF WASHINGTON LOOMIS WAUCONDA BAKER KETTLE FALLS HIGHLANDS Natural Resources BRIAN J. BOYLE-COMMISSIONER OF PUBLIC LANDS COLVILLE PEND OREILLE CASCADE SOUTH OKANOGAN NORTH COLUMBIA SKAGIT **NORTHEAST** CHEWELAH CLALL AM BAY POAT ANGELES STRAITS GRANITE FALLS RIVERS DEER PARK LOZETTE ARCADIA GUNDERSON WILLOUGHBY STARTUP HQH **NATIONAL PARK** WENATCHEE DIEETS L SOLLEKS SPOKANE QUINAULT (COLUMBIA BASIN NORTH/ MOSES LAKE GRAYS BLACK DIAMOND CLE ELUM RITZVILLE HARBOR RAINIER CARBONADO SOUTHEA\$T ELMALITTLE HARBOR POCK MT. RAINIER NATIONAL YAKIMA RIVER ELLENSBURG PARK PACIFIC AHTANUM ONALASKA TILTON MORTON TRI CITIES SNAKE RIVER DAYTON COLUMBIA TOUTLE GRAYS L ABERNATHY PROSSER TROUT KLICKITAT LAKE DNR MANAGEMENT BOUNDARIES WHITE SALMON STEVENSON JULY 1982 BATTLEGROUND YACOLT **OLYMPIC** AREA WASHOUGAL 16 miles DISTRICT UNIT

BOARD OF NATURAL RESOURCES/DEPARTMENT RELATIONSHIP

The Board of Natural Resources consists of five members: The Governor or the Governor's designee, the Superintendent of Public Instruction, the Commissioner of Public Lands, the Dean of the College of Forest Resources of the University of Washington and the Dean of the College of Agriculture of Washington State University (RCW 43.30.040). The Board of Natural Resources establishes goals and policies governing the department and makes necessary regulations to carry out department duties.

The Oil and Gas Leasing Program is strictly controlled by statutes and regulations. Therefore, the Board has not taken an active role in program administration.

The role of the Board is to:

- Review and adopt goals and policies for trust management programs, including the goals and policies contained in the Oil and Gas Leasing Program.
- Review and comment on a regular basis on the department's performance and plans for trust land management programs, including the Oil and Gas Leasing Program.
- Set minimum royalties as prescribed in RCW 79.14.030.

OIL AND GAS CONSERVATION COMMITTEE/DEPARTMENT RELATIONSHIP

The purpose of the Oil and Gas Conservation Act is to foster, encourage and promote the exploration, development, production and use of oil and gas in the state in such manner as will prevent waste, assure maximum economic recovery of oil and gas and fully protect the rights of owners. The Act also ensures that such oil and gas operations are conducted in a manner that will maintain a safe and healthful environment for the people of Washington (RCW 78.52.001). This Act established a committee to oversee the oil and gas resources of Washington.

The Oil and Gas Conservation Committee is composed of seven members: The Commissioner of Public Lands, the State Treasurer, the director of the Department of Ecology and four residents of the state of Washington appointed by the Governor (RCW 78.52.020). The Committee administers and enforces

the provisions of the Oil and Gas Conservation Act by adopting policies, regulations and orders. The Committee is vested with jurisdictional power and authority over all persons and property, public and private, necessary to enforce the Act (RCW 78.52.040). The Committee participates in and administers the Federal Safe Drinking Water Act in conjunction with the Departments of Ecology, Natural Resources and Social and Health Services.

The Department of Natural Resources is the designated agent of the Committee. The department appoints a state Oil and Gas Supervisor (usually the Division of Geology and Earth Resources Manager) whose duties are determined by the department. The department may designate one or more Deputy Oil and Gas Supervisors and employ all personnel necessary to carry out the Act and orders of the Committee (RCW 78.52.037).